Relying on the portion of Section 64 (b) just quoted, petitioners contend, and have contended throughout this proceeding, that the City was entitled in bankruptcy proceedings, to assert any right of priority of payment of its claim, given to it under applicable Nebraska law. And petitioners contend and have contended that under Nebraska law the City was entitled to priority of payment of its claim on two grounds, the first being that under Nebraska law a cestui que trust, contrary to the more general rule, is entitled to priority of payment out of the assets of the estate of an insolvent trustee upon a showing that the trustee's estate was augmented by the property of the cestui. Numerous Nebraska cases sustain this doctrine.

The second ground asserted is that under Nebraska law the City has the same right as a sovereign to priority of payment of its claims as existed under the common law which has been adopted by statute in Nebraska. This question is discussed more in detail at pages 25-30 hereof.

The Supreme Court in granting the writ in this case limited the scope of the review to the application of Section 64 (b) of the Bankruptcy Act. Broadly this could be interpreted to include not only the question of the construction of the applicable section of the Bankruptcy Act with regard to the question of whether a municipality was included within the meaning of Section 64 (b), but also the question of whether or not under the applicable Nebraska law the City is entitled to priority of payment. Viewed more literally the order of this court may be taken to limit the scope of the review to the question of construction of Section 64 (b) of the act and after considerable doubt the brief herewith submitted is based upon this latter assumption.

If a final determination of this cause is to be made by this court upon the question to which the review is thus limited, then we presume that the findings of the Circuit Court of Appeals on the question of local law will be deemed final. On the first point the Circuit Court of Appeals found that there was no trust relationship between the City and the Lincoln Trust Company. While it is and has been contended that this finding is erroneous, for present purposes it must be assumed that regardless of the finding of this court on the particular question considered, no rights can be asserted or based on the claim that there existed a trust relationship.

The Circuit Court of Appeals disposed of the second ground for priority asserted by petitioner on the broader question of the construction of the Bankruptcy Act, but considering the question of priority stated (R. 122):

> "It is earnestly urged that by right of sovereignty, the City is entitled to priority in the payment of its claim. At common law, the Crown had a priority over all subjects for the payment of debts due it. In a receivership case arising in a state where the common law prevailed without statutory modification, and where the Supreme Court of the State had not theretofore passed upon the question, we held that such prerogative right inhered in a city as an agency of the state exercising a delegated sovereignty. *City and County of Denver* v. *Stenger*, (C. C. A. 8) 295 Fed. 809."

In view of this finding we submit that if this court is of the opinion that Section 64 (b) of the Bankruptcy Act applies to municipal corporations, then it follows that petitioners are entitled to a final order allowing the City priority in the payment of its claim. The authorities submitted in support of the finding of the Circuit Court

of Appeals perhaps are not material in view of the limitation placed upon the scope of the review and for this reason no attempt has been made to be exhaustive on this point, our purpose merely being to briefly set forth the reasons for the finding of the Circuit Court of Appeals regarding the particular question.

I.

Section 64 (b) of the Bankruptcy Act giving priority to payment of debts entitled to priority under the laws of the States or of the United States applies to a municipal corporation, but was erroneously construed by the Circuit Court of Appeals to exclude such a corporation from any priority whatever.

Section 64 (b) of the Bankruptcy Act (11 U. S. C. A. 104 [b]), insomuch as it is involved in the present case, is set forth on page 5 hereof.

The only question of interpretation before the Court is whether a debt owing to a municipal corporation is included within the meaning of this section of the Bankruptcy Act. The Supreme Court has not had occasion to construe the particular sub-section quoted since it was changed by amendment in 1926. The particular question has never been presented to the court either before or after the amendment.

The provisions of sub-section (7) prior to the amendment are to be found in sub-section (5) which then read as follows:

> "The debts to have priority, except as herein provided, and to be paid in full out of the bankrupt estates and the order of payment shall be * * * (5) debts owing to any person who by the laws of the States or the United States is entitled to priority."

In reaching the conclusion that Section 64 (b) did not apply to a debt owing to a municipal corporation, the Circuit Court of Appeals said (R. 122):

> "It is contended that this section of the bankruptcy act preserves the City's right as a sovereign to priority in payment of its debt in the provision that 'debts owing to any person who by the laws of the States or the United States is entitled to priority.' It is observed that the statute defines the scope to be given to the term 'person', it being provided that it shall include corporations, the United States and the several States and Territories of the United States.' It makes no mention of municipalities, counties, or other subdivisions of the Government, and hence, we think they are necessarily excluded."

In other words, the Circuit Court of Appeals has construed Section 64 (b) to exclude municipal corporations and deny them even the rights of priority to which any other corporation or person would be entitled. We believe such construction is unreasonable, unjustified, and results from a misinterpretation of the case of *Davis* v. *Pringle*, 268 U. S. 315.

1. Circuit Court of Appeals Misinterpreted Case of Davis v. Pringle.

The erroneous construction of the act in question results from a misinterpretation or a misapplication by the Circuit Court of Appeals of the principle announced in *Davis* v. *Pringle*, 268 U. S. 315. In that case Justice Holmes denies priority to the United States because other parts of the Bankruptcy Act in giving the United States priority specifically mention it by name and he therefore concludes that the United States was not intended to be included in the word "person". On this point Justice Holmes says:

> "It is incredible that after the conspicuous mention of the United States in the first place at the beginning of the section and the grant of a limited priority, Congress should have intended to smuggle in a general preference by muffled words at the end."

The Circuit Court of Appeals failed to recognize that a very different situation exists as to a municipal corporation for, as will hereafter be shown, wherever it was intended to exclude a municipal corporation a specific exception followed the word "corporation". In other words, it will be observed that the Bankruptcy Act treats a municipal corporation as included within the general designation "corporation" and where it is desired to exclude municipal corporations it is mentioned as a specific exception to "corporations".

That a municipal corporation is included in the word "person" as used in the Bankruptcy Act is shown by Section 4a of the Bankruptcy Act, 11 U. S. C. A., Sec. 22, which provides as follows:

> "Any **person, except a municipal,** railroad insurance, or banking **corporation,** shall be entitled to the benefits of this title as a voluntary bankrupt."

It is apparent that if a municipal corporation was not included in the word "person", there would be no reason to except it from the operation thereof.

That the word "corporation" as used in the Bankruptcy Act includes a municipal corporation, is shown by Section 4b of the Bankruptcy Act, 11 U. S. C. A., Sec. 22, which provides in part:

> "* * * **any** moneyed business, or commercial **corporation, except a municipal,** railroad, insurance, **banking corporation,** * * *."

If the word "corporation" did not include municipal corporations there would have been no reason to have included it in the exception.

It has been asserted that the word "corporations" as used in Section (7) means only a corporation as defined in Section (1) of the Bankruptcy Act, 11 U. S. C. A., Section 1 (6) which it is claimed would exclude municipal corporations. In examining this definition consideration should be given to the words at the beginning of the section. These words are "The words and phrases used in this title and in proceedings pursuant hereto shall, **unless the same be inconsistent with the context,** be construed as follows: "* * * (6) 'Corporations' shall mean all bodies having **any** of the powers and privileges of private corporations not possessed by individuals or partnerships * * *." This definition could easily include municipal corporations as they are bodies having some of the powers and privileges of private corporations not possessed by individuals and partnerships as for example the power privilege of perpetual succession. But even if intended to exclude municipal corporations, we believe the qualifying words "unless the same be inconsistent with the context" should be applied to the use of the word "corporation" in Section 64 (b) (7) and a construction thereof denying to a municipal corporation the same rights of priority allowed a private corporation is unjustified. In *Re Worcester County*, 102 Fed. 808, 815 (1 C. C. A.), it was held that a county was included in Section 64 (b) because Section 1 (6) defined a person as including a corporation and a county was a corporation.

Opposing counsel have asserted that because Section 64 (a) specificially directs the payment of taxes prior

to other debts, Section 64 (b) should not be construed to include a municipal corporation. We do not agree with this contention. Section 64 (a) provides:

> "The court shall order the trustee to pay all taxes legally due and owing by the bankrupt to the United States, state, county, district or municipality, * * *."

The use of the word "municipality" in the section just quoted does not militate against the argument heretofore made by us. It is not used in contradiction to the word "corporation". It is obvious that the word "corporation" would be inappropriate to use in this part of the law because taxes are not payable to corporations generally, but only to governmental agencies, which it will be observed are specifically described.

The corollary of the principle announced in *Davis v. Pringle, supra,* is that where in some instances a law specifically excepts a special class from a general class the use of the word describing the general class without the exception clearly shows an intention to treat the special class as covered by the words used to describe the general class. In other words, an examination of the entire Bankruptcy Act shows it intends to include municipal corporations within the designation "corporations" or "persons" unless specifically excepted. Therefore, a municipal corporation is included in the priority granted by Section 64 (b) because not specifically excluded by an exception.

The quotation on page 10 hereof from Justice Holmes' opinion might be properly paraphrased to apply to this case as follows:

> "It is incredible that after the conspicuous mention of a municipal corporation as an exception

> the use of the word 'corporation', Congress should have intended to smuggle in a specific exception to a general preference by attaching a limited meaning to the word 'corporation' which would exclude municipal corporations."

We believe that the reasoning of Justice Holmes when applied to the different situation existing as to municipal corporations fully justifies the conclusion that municipal corporations were entitled to priority under Section 64 (b) before the 1926 Amendment. If there was any doubt existing prior to 1926, as to the intention of Congress to allow priority to all creditors, it was removed by the amendment made that year, adding the words:

> "* * * provided, that the term 'person' as used in this section shall include corporations, the United States and the several states and territories of the United States."

The presumption is that Congress was aware of the construction placed upon the act by this court. (See *Jordan* v. *Roche*, 228 U. S. 436, 445, 446; *In re Hauger*, 54 Fed. [2d] 117 [D. C. Texas]). Therefore, in adding the 1926 Amendment, Congress showed clearly that it had intended Section 64 (b) to cover debts owing every kind of creditor, including the United States, the several states and territories of United States and corporations generally and the amendment is a rejection of the limitation placed on the act by the court in *Davis* v. *Pringle*. The purpose of the amendment, we believe, to be a declaration of the prior legislative intent, that the word persons shall be construed liberally to include all to whom or to which the debts described may be owing. Contrary to the more usual function of a proviso, to limit and cut down, the meaning of a preceding general term, the function here is to enlarge the meaning of "persons" if there

be any doubt as to the inclusiveness of the term. The office of a proviso is not always one of limitation, but its effect is to be ascertained from a general view of the statute. *Detroit Street R. Co.* v. *Detroit,* 64 Fed. 629, 645 (C. C. A. 6); *Ohio* v. *Helvering,* 292 U. S. 360, 370. See also, *Georgia Banking Co.* v. *Smith,* 128 U. S. 174, 181, where it is said:

> "The general purpose of a proviso, as is well known, is to except the clause covered by it, from the general provisions of a statute, or from some provisions of it, or to qualify the operation of the statute in some particular. **But it is often used in other senses.** It is a common practice in legislative proceedings, on the consideration of bills, for parties desirous of securing amendments to them, to precede their proposed amendments with the term 'provided', so as to declare that, notwithstanding existing provisions, the one thus expressed is to prevail, thus having no greater signification than would be attached to the conjunction 'but' or 'and' in the same place, and simply serving to separate or distinguish the different paragraphs or sentences."

Our contention as to the purpose of the 1926 Amendment and the proper application of the principle announced in *Davis* v. *Pringle,* is supported by an article in the Harvard Law Review, Volume 40, pages 345 and 346, written by James Angell McLaughlin, a professor in Harvard Law School. In discussing this question, he says:

> "The rule of *Davis* v. *Pringle* is reversed, and the United States and the states are expressly declared to be 'persons' which may have priority in bankruptcy on claims other than taxes in accordance with other federal or state laws. Such priority remains of a deferred class—that immediately preceding the claims of creditors to dividends.

"It has been pointed out that litigation may arise by reason of the fact that it is not expressly declared that counties, districts or municipalities are entitled to such priority on claims other than taxes. This is in contrast to the language of Section 64 (a) which specifies that taxes owing to 'the United States, state, county, district or municipality' shall have the next preceding degree of priority. The argument will be made that such governmental units are by implication denied priority on other than tax claims even when it is granted them by state law. **As applied to municipal corporations such an argument should not prevail.** *Davis* v. *Pringle* was a case of priority claimed by the United States. The argument for the government upon the act as it stood was this. Section 64 (b) gives persons priority in accordance with the laws of the United States. The United States is a corporation, a corporation is a person as defined in Section 1 (19), and is entitled to priority by reason of Section 3466 of the Revised Statutes. The Supreme Court thought that Congress would, if it intended the United States to have the claimed priority in bankruptcy, have provided for it by direct expression instead of through such a 'logical concatenation.' Shortly before the Act of 1926, the decision had been interpreted to exclude a state from priority provided by the state Law. **The amendment in repudiating Davis v. Pringle as applied both to its own facts and to state priorities would seem to be a repudiation of the reasoning on which that case is based. A municipal corporation is clearly a person within the Bankruptcy Act not only because the definition of a person covers it, but because it is expressly referred to as a person in Section 4 (a). Furthermore there is less reason to apply the rule of Davis v. Pringle to a state or a municipal corporation than to the United States.** If Congress meant the United States to have a priority, it could easily have said so. There has never been even a suggestion that Congress should set up a priority

> for states or municipalities that the states would not claim for themselves or establish for the benefit of their municipalities. **With reference to these, the natural thing was simply to allow them to be covered by a general clause recognizing priorities established by state law."**

The reasoning in the foregoing article by Professor McLaughlin is logical. The construction which he places on this amendment and the decision in *Davis* v. *Pringle* justifies the inclusion of a debt due a municipal corporation within the provisions of Section 64 (b).

2. Legislative Intent Should Be Considered In Construing A Statute.

It is, of course, proper to consider the legislative intention as indicated by the adoption of the law and the amendment thereto.

The case of *Barrett* v. *Van Pelt*, 268 U. S. 85, in which the principle discussed is reiterated is interesting in illustrating the extent to which the court will go in effectuating the intent of the legislative body. In this case the court in construing a section of a statute did not merely give a broad interpretation to a word found therein, but actually supplied a different word and construed the provisions of the act as though the legislature had inserted the supplied word in lieu of the term actually found within the act.

In the opinion Justice Butler says:

> "* * * The intention of the law-maker constitutes the law. *Stewart* v. *Kahn, Stewart* v. *Bloom*, 11 Wall. 493, 504. See *Smythe* v. *Fiske*, 23 Wall, 374, 380. Being satisfied of the legislative intention, the court will not be prevented from giving that intention

effect by a too rigid adherence to the very word and letter of the Statute. *Oates* v. *First National Bank*, 100 U. S. 239, 244. Having found that the word 'damage' was intended to be used, the court applies the rule that, 'A thing which is within the intention of the makers of a statute is as much within the Statute as if it were within the letter; and a thing which is within the letter of a statute, is not within the statute, unless it is within the intention of the makers.' *People* v. *Utica Insurance Company*, 15 Johns. 358, 381; *Hawaii* v. *Mankicki*, 190 U. S. 197, 212."

The intention of Congress appears to have been to provide in this case for the order of payment of various types of "debts." The term emphasized throughout Section 64 (b) is "debts". Congress was apparently not concerned with the question as to whom such debts were owed. It sought to classify various obligations, depending upon their nature, and fixed an equitable and practical order of priority. Claims representing costs of administration are preferred. The reason is practical. If this type of claim is not preferred there will probably be no proper administration and debtors might not receive anything. An examination of this section shows the emphasis is not towards the claimant, but is on the nature of the debt. Having this emphasis in mind, the word "person", as used in the last sub-section, is of the broadest possible scope. It is in the nature of an omnibus section. All debts differing in some way from ordinary debts so that under local or federal law, in the absence of bankruptcy they would be preferred, are given a priority in the order of payment over common debts. The purpose is to preserve valid rights, presumably acquired through diligence or valid rights acquired because as a matter of policy local laws deem certain debts shall have precedence in the order of payment from insolvent estates. The nature

of the debt with regard to its priority of payment under local law is the point emphasized. Wherever there is a debt there must be a creditor, and the word "person" is used in this sense, that is, it is co-extensive in scope with the scope of the debts included within the meaning of the section.

That Congress intended Section 64 (b) to apply to all debts of the classes mentioned regardless of the kind of a creditor, is emphasized by the 1926 Amendment broadening the scope of the word "person", as applied to creditors. To exclude a municipal corporation from the terms of this section as amended, is to ascribe to Congress an intention to draw a distinction where none in fact exists.

3. A Reasonable Construction Should Be Given To A Statute To Effectuate The Legislative Intention.

The principle that a reasonable construction should be given to a statute to carry out the legislative intention is, of course, well established. It is stated by Justice Sutherland in *Ozawa* v. *United States*, 260 U. S. 178, in the following language:

> "It is the duty of this court to give effect to the intent of Congress. Primarily this intent is ascertained by giving the words their natural significance; but if this leads to an unreasonable result plainly at variance with the policy of the legislation as a whole, we must examine the matter further. We may then look to the reason of the enactment and inquire into its antecedent history and give it effect in accordance with its design and purpose, sacrificing, if necessary, the literal meaning in order that the purpose may not fail: See *Holy Trinity Church* v. *United States*,

143 U. S. 457; *Heydenfeldt* v. *Daney Gold Mining Company*, 93 U. S. 634, 638."

The same principle is stated by Justice Roberts in the recent case of *Royal Indem. Co.* v. *American Bond & Mortgage Co.*, 289 U. S. 165, 169, as follows:

"* * * We should therefore construe the language of the act so as to effectuate the evident purpose of the legislation, and not so narrowly as to defeat the true intent of Congress."

The manifest intention of Congress in passing Section 64 (b) seems to have been to provide for the allowance of priority to any debts entitled to such priority in the absence of bankruptcy. No other intention can reasonably be ascribed to that section. This intention is emphasized by the 1926 Amendment in enlarging the scope of the original language to include not only the United States, which had been excluded by the court's construction in *Davis* v. *Pringle, supra*, but also to specifically include corporations, states and territories. No sound reason for excluding a debt due a municipal corporation can be found.

This court has recently passed upon a very similar situation which strongly supports our contention. In *Ohio* v. *Helvering*, 292 U. S. 360, 370, the word "person", as well as the word "corporation", were each construed to include a state. In holding that a state was included within the term "person", as used in the United States statute imposing a tax on every person selling liquor, Justice Sutherland says:

"**We find no merit in the further contention that a state is not embraced within the meaning of the word 'person'**, as used in U. S. C. title 26, Sec. 205 and defined in Sec. 11, supra. By Sec. 205

the tax is levied upon every 'person who sells, etc.;' and by Sec. 11 the word 'person' is to be construed as meaning and including a partnership, association, company or corporation, as well as a natural person. Whether the word 'person' or 'corporation' includes a state or the United States depends upon the connection in which the word is found. Thus, in *Stanley* v. *Schwalby*, 147 U. S. 508, 517, 37 L. ed. 259, 263, 13 S. Ct. 418, it is said that the word 'person' in the statute there under consideration would include the United States as a body politic and corporate. See also *Giddings* v. *Holter*, 19 Mont. 263, 266, 48 Pac. 8; *State* v. *Herold*, 9 Kan. 194, 199. A state is a person within the meaning of a statute punishing the false making or fraudulent alteration of a public record 'with intent that any person may be defrauded.' *Martin* v. *State*, 24 Tex. 61, 68. Under a statute defining a negotiable note as a note made by one person whereby he promises to pay money to another person, and providing that the word 'person' should be construed to extend to every corporation capable by law of making contracts, it was held that the word included a state. *Indiana* v. *Woram*, 6 Hill 33, 38, 40 Am. Dec. 378. **And a state is a person or a corporation within the purview of the priority provisions of the bankruptcy act.** Re *Western Implement Co.*, (D. C.) 166 Fed. 576, 582. Compare *Re Jensen*, 28 Misc. 378, 59 N. Y. Supp. 653, 655; *Bray* v. *Wallingford*, 20 Conn. 416, 418; *Lancaster County* v. *Trimble*, 34 Neb. 752, 756, 52 N. W. 711; *Rains* v. *Oshkosh*, 14 Wis. 372, 374; 1 Bl. Com. 123."

It will be observed that the court specifically recognizes that "a state is a person or a corporation within the purview of the priority provisions of the bankruptcy act". The priority provision referred to is Section 64 (b). If a state is within the meaning of the word "corporation"

as used in this section, certainly a municipal corporation would likewise be included. After then discussing a different view, Justice Sutherland continues:

> "* * * While not rejecting that view, we prefer, in the light of the foregoing examples, to place our ruling upon the broader ground that the state itself, when it becomes a dealer in intoxicating liquors, falls within the reach of the tax either as a 'person' under the statutory extension of that word to include a corporation, or as a 'person' without regard to such extension."

The principle announced is even more applicable to the present case. In the foregoing case a reason for not including the state within the term of either "person" or "corporation" and thus making it subject to an excise tax was the constitutional provision against taxing the state. But even so the court rejected that reason and held there was no basis for discriminating in favor of the state. In the present case no reason of any kind exists for holding a municipal corporation is not included within the meaning of either the term "person" or "corporation" as used in Section 64 (b). Likewise there is no basis for discriminating against a municipal corporation by denying it any priority whatever under this section while allowing priorities to any other person, corporation, state, territory and the United States.

Not only is it reasonable to consider municipal corporations included in the general designation of persons or corporations, but also it would seem proper to treat a municipal corporation as included in the term "states". A municipal corporation is merely a subdivision or part of a state and has been frequently referred to by the courts as an agency of the state.

According to *City of Denver* v. *Stenger*, 295 Fed. 809 (C. C. A. 8), the city is an agency of the state and is therefore entitled to every right of priority that is possessed by the state. In *Trenton* v. *New Jersey*, 262 U. S. 182, 187, the court says: "A municipality is merely a department of the state." In *Worcester* v. *Worcester Co.*, 196 U. S. 539, 548, the court says: "A municipal corporation is simply a political subdivision of the state." If a city is "merely a department of the state," or "simply a political subdivision of the state", it would seem most unreasonable to hold that a city should be denied the priority accorded the state of which it is a part.

In *Re Worcester County*, 102 Fed. 808, 815 (1 C. C. A.), it was held that the provisions of Section 64 (b) applied to a county. The court determined that a county was a corporation and therefore Section 64 (b) applied because the word person used therein was defined by Section 1 of the Bankruptcy Act to include a corporation.

Construing the language to effectuate the evident purpose of the legislature, namely, to allow priority to all debts entitled to priority under a state or federal law, a debt due a corporation must certainly be included within Section 64 (b).

4. A Statute Should Be Construed To Avoid Unjust or Absurd Results.

Wherever possible a construction will be placed on a statute to avoid an unjust or absurd result. This rule is stated by Justice Cardozo in *Burnet* v. *Guggenheim*, 288 U. S. 280, 286, as follows:

> "A statute will be construed in such a way as to avoid unnecessary hardship when its meaning is uncertain."

The same principle is stated by Justice Stone in *U. S. v. Ryan*, 284 U. S. 167, 175, in the following language:

> "All laws are to be given a sensible construction. A literal application of a statute which would lead to absurd consequences is to be avoided whenever a reasonable application can be given which is consistent with the legislative purpose."

The foregoing rules should conclusively establish the correctness of the construction of Section 64 (b) to include debts due a municipal corporation. Certainly to construe this statute to exclude such debts but to include those due all other types of creditors will produce not only absurd, but also unjust results. No reason to thus discriminate against municipal corporations exists. In *Wheeler* v. *Johnson*, 26 Fed. (2d) 455 (8 C. C. A.), debts due creditors or depositors of a failed bank were held to be entitled to priority against an insolvent stockholder of the bank under Section 64 (b) because given priority under a state statute. Suppose one of the creditors or depositors was a municipal corporation. Under the decree of the court in the present case every creditor of the bank would be entitled to priority except the municipal corporation. A construction of Section 64 (b) leading to such an absurd result is utterly unjustified. Surely the minimum consideration given such a corporation would be to allow it at least the same rights as other corporations and individuals. There is no conceivable reason why a state should be protected and a subdivision thereof excluded. Congress, acting for the people, cannot be presumed to have an intention to hamper municipal cor-

porations in the collection of their obligations where no like inhibition is provided as to private corporations and where there is no distinction. The very reason why sovereigns are allowed a priority, namely, to protect and conserve public funds, should entitle a city to the same rights as a state. In the recent case of *Helvering* v. *New York Trust Co.*, 292 U. S. 455, in discussing the effect of a literal construction of a tax law, Justice Butler says:

> "In respect of the legislative purpose to lessen hindrance caused by high normal and surtaxes, there is no distinction between gains derived from a sale made by an owner who has held the property for more than two years and those resulting from one by a donee whose tenure plus that of the donor exceeds that period.
>
> "* * * No valid ground has been suggested for requiring tenures to be added for the one purpose and forbidding combination for the other. The legislative purpose to be served by the application of the lower rate upon capital gains is directly opposed to the Commissioner's Construction. **There is no ground for discrimination** such as that to which the trustee was subjected. **It is to be inferred that Congress did not intend penalization of that sort.**"

And it may likewise be inferred that Congress did not intend to penalize municipal corporations in the collection of their debts by the terms of Section 64 (b) of the Bankruptcy Act and the wording of this section far more readily lends itself to the construction we contend for than the wording of the revenue act lent itself to the construction placed upon it by the court in *Helvering* v. *New York Trust Co., supra.* The unjust and absurd consequences resulting from the construction placed on this act by the Circuit Court of Appeals should alone justify a reversal of this judgment.

II.

Section 64 (b) of the Bankruptcy Act applies and under it a municipal corporation is entitled to the common law right of priority accorded a sovereign which has been adopted by the statutes of Nebraska.

If we have established that Section 64 (b) applies to a municipal corporation, then it becomes important to determine whether its application gives to petitioners the priority asserted. We therefore deem it proper to discuss this specific priority which petitioners claim.

1. Sovereign Is Entitled To Priority In Payment Over General Creditors.

The rule that a sovereign is entitled to priority over general creditors is recognized in *Marshall* v. *New York*, 254 U. S. 380, 382, 386. In that case the State of New York claimed a priority from a receiver appointed by a federal court, for a franchise tax due under a New York law.

The court granted the priority in that case even though there was no New York statute relating to the adoption of the common law. On this point the court says on page 386:

> "The fact that the right rests on the common law, independently of any statute, does not, of course, affect the right of enforcement in the Federal courts."

The Eighth Circuit in *City of Denver* v. *Stenger*, 295 Fed. 809, approved the granting of priority to a sovereign. This case will be discussed under the next heading.

2. Common Law Right of A Sovereign To Priority Has Been Adopted By Statute of Nebraska.

The right of a sovereign to priority has been adopted by statutory enactment in Nebraska and such right of priority belongs not only to the State of Nebraska, but to the City as its agent.

Section 49-101 of the C. S. of Nebr. for 1929, provides:

> "**Common Law in Force.** So much of the common law of England as is applicable and not inconsistent with the constitution of the United States, with the organic law of this state, or with any law passed or to be passed by the legislature of this state, is adopted and declared to be law within the State of Nebraska (R. S. p. 31; Ann. 6955; Comp. 1934; R. S. 1913, 3697; C. S. 1922, 3085)."

Although this statute has been repeatedly applied by the Supreme Court of Nebraska, it has never had occasion to consider it in connection with the sovereign right of priority. However, a decision of the Eighth Circuit Court of Appeals in *City of Denver* v. *Stenger,* 295 Fed. 809, is directly in point and fully supports the right of the City to priority. In that case the City and County of Denver claim priority in the payment of its claim against the Receiver of the Denver Tramway Company for payments due it under a contract granting to the company the right to the use of certain streets. Judge Stone in deciding the case held that the claim was entitled to priority not on the theory that it was a tax or a rental, but because it was a debt due a sovereign. Because of the logical disposition made of the many objections raised to granting priority, we quote at length from the opinion. In discussing these questions the court says on page 815:

"The final contention is that the claim is entitled to the priority accorded a debt due the sovereign under the common law. We think this contention well founded. **Under the common law, the sovereign had a right to a certain preference in payment.** *Marshall* v. *N. Y.*, 254 U. S. 380, 382, 41 Sup. Ct. 143, 65 L. Ed. 315; *United States* v. *Bank of N. C.*, 6 Pet. 29, 35, 8 L. Ed. 308. The common law is by statutory authority (section 6516, Comp. L. Colo. 1921), in force in Colorado. **Appellant is an agency of the state exercising the delegated sovereignty thereof in local matters. It is entitled to whatever priority the state might demand.** Appellee challenges any such priority on four grounds: That no decision of the Colorado courts has held that such priority exists as a prerogative right of the sovereign instead of as a mere administrative rule; that the priority applies only to a tax and this is not a tax; that the basis for this franchise obligation rests solely on exercise of the power of the proprietor and not of the sovereign; that the right is lost when specific liens exist in advance of assertion of such priority. The logical result of the first contention would be that, although this attribute and advantage attaching to sovereignty was recognized and enforced at common law and although the common law is placed in full force by the statute of a state yet, until the highest court of that state shall declare this right to exist as a prerogative of sovereignty, no federal court can recognize it. This is, in effect, to require federal courts to recognize the right as purely a domestic administrative policy of the state until the high state court has declared it to be prerogative. If any presumption must be indulged, why not make use of the more reasonable one, which is that this undoubted right of the state is enforceable in any form? Since the rule has ref-

erence to the public good it should receive no strict nor narrow interpretation." *United States* v. *Bank of N. C.*, 6 Pet. 29, 35, 8 L. Ed. 308:

"The second contention, that the priority of the sovereign attaches only to taxes, is unsound. **The reason for the rule is public policy which declares that it is more important for the state—all of the people—to have its money than for any single citizen or group of citizens. The rule covers all manner of debts due the state** (*United States* v. *Bank of N. C.*, 6 Pet. 29, 35, 8 L. Ed. 308), whether the origin of such be involuntary imposts or voluntary obligations (*Marshall* v. *New York*, 254 U. S. 380, 382, 383, 41 Sup. Ct. 143, 65 L. Ed. 315, and cases there cited). The above determination of the second contention disposes of the third contention that the obligation under this franchise is based on the proprietary function of the municipality. This is so, because if the rule applies to all debts due the state, it would cover those arising from exercise of proprietary functions, hence it is immaterial here and we need not inquire whether the municipality was exercising a proprietary or a sovereign function."

The Colorado statute, Sec. 6516, Comp. L. Colo. 1921, provides in part "the common law of England, so far as the same is applicable and of a general nature * * * shall be the rule of decision and shall be considered as of full force until repealed by legislative authority." The Nebraska statute, as quoted on page 26 hereof, is substantially the same as the Colorado statute except the qualifying words "of a general nature" do not appear in the Nebraska statute.

It will be observed the court specifically decides that a city is entitled to such priority. On this point Judge Stone says:

> "* * * **Appellant is an agency of the state exercising the delegated sovereignty thereof in local matters. It is entitled to whatever priority the state might demand.**"

The rule that a city is an agency and subdivision of the state is recognized by this court in *Worcester* v. *Worcester Co.*, 196 U. S. 539, and *Trenton* v. *New Jersey*, 262 U. S. 182. If a city is merely a department or subdivision of the state, the holding of the court in *City of Denver* v. *Stenger*, *supra*, that a city is entitled to the same priority as the state is logical.

The reason why a sovereign is given the right of priority applies with equal force to a debt due a city as well as a debt due a state. It was stated by Judge Stone in the *City of Denver* v. *Stenger* case as follows:

> "* * * **The reason for the rule is public policy which declares that it is more important for the state—all of the people—to have its money than for any single citizen or group of citizens.**"

It will also be observed that Judge Stone says in the foregoing case:

> "* * * Since the rule has reference to the public good it should receive no strict nor narrow interpretation. *United States* v. *Bank of N. C.*, 6 Pet. 29, 35, 8 L. Ed. 308."

The case of *Aetna Casualty & Surety Co.* v. *Bramwell*, 12 Fed. (2d) 307 (D. C. Ore.), has been cited as holding the *Denver* v. *Stenger* case was not controlling because later the Supreme Court of Colorado held the common law right of priority had not been adopted in that state. But such a decision would not change the rule announced in

City of Denver v. *Stenger* that in the absence of a controlling decision by a state court the sovereign right of priority became a part of the laws of the state, which by express statute had adopted the common law.

The *Denver* v. *Stenger* case is therefore squarely in point and determines that the right of a sovereign to priority has become a part of the Nebraska law and such sovereign right belongs to a city as an agent of the state.

3. Right of Sovereign To Priority Is Recognized In Bankruptcy Proceedings.

The foregoing rule that a sovereign is entitled to priority in payment of its debt applies in bankruptcy proceedings. In *Alamac Operating Corporation*, 42 Fed. (2d) 120 (C. C. A. 2), it was held that the right of the State of New York as a sovereign to priority in the payment of its debt was enforceable in bankruptcy proceedings. The same rule was followed in *State of Oregon* v. *Ingram*, 63 Fed. (2d) 417 (C. C. A. 9), certiorari denied, 290 U. S. 630, and *In re Martin*, 75 Fed. (2d) 618. In the last mentioned case the court in rejecting appellant's contention said:

> "Indeed, if appellant were correct in his assertion that bankruptcy was such a transfer of the debtor's property as would destroy the state's priority, section 64b (7) would wholly fail of its manifest purpose to preserve in bankruptcy whatever right of priority the creditor had under the laws of the state before the bankruptcy intervened."

CONCLUSION.

We earnestly contend that a reasonable interpretation of the language used in Section 64 (b) shows a legisla-

tive intention to give all debts the same priority which they would have received under the laws of a state or of the United States. To construe this section to exclude a municipal corporation from any priority whatever is an unjust and an unfair discrimination against such corporations. If the law is construed to apply to municipal corporations, unnecessary hardships and absurd consequences will be avoided and at the same time the legislative intention will be effectuated.

If Section 64 (b) is construed to apply to a municipal corporation, then it should be applied in the present case to give the City the priority accorded a sovereign. This court has heretofore held in *Marshall* v. *N. Y.*, 254 U. S. 380, that at common law a sovereign was entitled to priority in the payment of debts due it. The opinion of the Circuit Court of Appeals in the present case recognizes the correctness of the rule previously announced in *City of Denver* v. *Stenger*, that a state statute adopting the common law includes the right of a sovereign to priority. The Nebraska statute adopting the common law is even broader than the Colorado statute construed in the foregoing case. Furthermore, in *City of Denver* v. *Stenger* the common law right of a sovereign is given to a city as an agent or subdivision of the state. This seems to be a proper application of the rule. The reason for the rule, namely, the protection of public funds, justifies the granting of such priority to a city the same as a state. In other words, there is just as much reason to protect the public funds of a city as to protect the public funds of a state. Particularly is this construction justified in view of the statement by Justice Story in *U. S.* v. *Bank of N. C.*, 31 U. S. 29, 35, that since the rule of sovereign priority has reference to the public good, it should not receive a strict and narrow interpretation."

We respectfully submit that Section 64 (b) applies to the claim involved herein and that the judgment of the Circuit Court of Appeals should be reversed with directions to allow the claim priority under subparagraph 7 of Section 64 (b).

Respectfully submitted,

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